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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 24.

BRITISH-AMERICAN TOBACCO COMPANY, LTD.,
Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONER

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INDEX

	PAGE
OPINIONS BELOW	1
JURISDICTION	1
QUESTIONS PRESENTED	2
STATUTES INVOLVED	2
STATEMENT	6
SPECIFICATION OF ERRORS TO BE URGED	7
SUMMARY OF ARGUMENT	8
ARGUMENT:	
I. The word "obligations" as used in Section 217 (a) (1), relating to foreign corporations and non-resident aliens should be construed in the sense of contractual duties and not in so broad a sense as to embrace statutory duties such as the duty to refund taxes illegally collected	10
II. The United States is not a "resident" of the United States, "corporate or otherwise", within the meaning of Section 217 of the Revenue Act of 1926	23
III. If the word "obligations" as used in Section 217 is given the broad meaning which would make interest on tax refunds taxable, the same meaning must be given to the same word in Section 213 (b) (4) and the interest is expressly exempted from taxation	28
IV. It is the intention of the Revenue Act of 1926, unequivocally expressed in Sections 213 and 236, to exclude from the income of foreign corporations upon which the corporation income tax is imposed by Section 230 of the Act, all interest which may fall within any possible defini-	

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Opinions Below.

The opinion of the Circuit Court of Appeals for the Second Circuit (R. 32) is reported at 69 Fed. (2d) 528. The opinion of the Board of Tax Appeals (R. 15) is reported in 27 B. T. A. 226. A former opinion of the Board of Tax Appeals (R. 13), which was reversed by its decision reported in 27 B. T. A. 226, is unreported.

Jurisdiction.

The judgment below was entered March 12, 1934 (R. 38). The petition for a writ of certiorari was filed April

23, 1934 and was granted May 7, 1934. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

Whether interest paid by the United States pursuant to Section 1116 (a) of the Revenue Act of 1926 to a foreign corporation upon a refund of taxes previously overpaid is included in the category of "interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise" of the United States within the meaning of Sections 217 and 233 of the Revenue Act of 1926.

Whether such interest is exempt from taxation under the provisions of Section 213 (b) (4) (C) of the Revenue Act of 1926.

Whether, if such interest is properly included in the gross income of a foreign corporation pursuant to Sections 217 and 233 of the Revenue Act of 1926, such corporation is not entitled to a "credit" against its income in the amount of such interest pursuant to Section 236 of the Revenue Act of 1926.

Statutes Involved.

Revenue Act of 1926.

"TAX ON CORPORATIONS.

Sec. 230 (a) In lieu of the tax imposed by Section 230 of the Revenue Act of 1924 there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(1) For the calendar year 1925, 13 per centum of the amount of the net income in excess of the credits provided in Sections 236 and 263; and

(2) For each calendar year thereafter, 13½ per centum of such excess amount."

(U. S. C. App., Title 26, Sec. 981.)

"GROSS INCOME DEFINED.

Sec. 213. For the purposes of this title, except as otherwise provided in Section 233:

(a) The term 'gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme Court and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, of the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or

from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or

gains or profits and income derived from any source whatever.

"The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

"(b) The term 'gross income' does not include the following items, which shall be exempt from taxation under this title:

* * * * * * * *

"(4) Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or

"(B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or

"(C) the obligations of the United States or its possessions.

"Every person owning any of the obligations or securities enumerated in Clause (A), (B), or (C) shall, in the return required by this title, submit a statement showing the number and amount of such obligations and securities owned by him and the income received therefrom, in such form and with such information as the Commissioner may require.

"In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income taxes; * * *.

(U. S. C. App., Title 26, Sec. 954.)

"GROSS INCOME OF CORPORATIONS DEFINED.

"Sec. 233 (a). In the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 and 217,

except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them, less amounts paid for reinsurance.

"(b) In the case of a foreign corporation, gross income means only gross income from sources within

the United States, determined (except in the case of insurance companies subject to the tax imposed by sections 243 or 246) in the manner provided in section 217.

(U. S. C. App., Title 26, Sec. 985.)

"NET INCOME OF NONRESIDENT ALIEN INDIVIDUALS.

"Sec. 217 (a) In the case of a nonresident alien individual or of a citizen entitled to the benefits of section 262, the following items of gross income shall be treated as income from sources within the United States:

"(1) Interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including

"(A) interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States and not having an office or place of business therein, or

"(B) interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 per centum of the gross income of such resident payor or domestic corporation has been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such payor preceding the payment of such interest, or for such part of such period as may be applicable;

* * * * * * * *

"(c) The following items of gross income shall be treated as income from sources without the United States:

"(1) Interest other than that derived from

sources within the United States as provided in paragraph (1) of subdivision (a); * * *.

(U. S. C. App., Title 26, Sec. 958.)

"Sec. 236. For the purpose only of the tax imposed by section 230 there shall be allowed the following credits:

"(a) The amount received as interest upon obligations of the United States which is included in gross income under section 233; * * *

(U. S. C. App., Title 26, Sec. 988.)

"Sec. 1116 (a) Upon the allowance of a credit or refund of any internal-revenue tax erroneously or illegally assessed or collected, or of any penalty collected without authority, or of any sum which was excessive or in any manner wrongfully collected, interest shall be allowed and paid on the amount of such credit or refund at the rate of 6 per centum per annum from the date such tax, penalty, or sum was paid to the date of the allowance of the refund, or in the case of a credit, to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment made under the Revenue Act of 1921, the Revenue Act of 1924, or this Act, then to the date of the assessment of that amount."

(U. S. C. App., Title 26, Sec. 153.)

Statement.

During the years 1925 and 1926, petitioner, a foreign corporation with an office in New York City, received from the United States $132,407.17 and $1,394,357.64, respectively, interest upon overpayment of Federal income and excess profits taxes (R. 11, 12). In its income tax returns for those years the petitioner reported the money so received as non-taxable income (R. 11, 12). The Commis-

sioner held that it was taxable and determined deficiencies accordingly. An appeal was taken to the Board of Tax Appeals, where, by decision entered March 9, 1932, the action of the Commissioner was affirmed (R. 14). On August 22, 1932, that decision was vacated and set aside (R. 15), and the Board, with three members dissenting, reversed its previous decision and the Commissioner's determination and held that the interest so received did not constitute taxable income. The Commissioner filed a petition for a review of the judgment of the Board of Tax Appeals with the Circuit Court of Appeals for the Second Circuit, which Court reversed the judgment of the Board of Tax Appeals (R. 38). The Circuit Court of Appeals held expressly that the interest received by the petitioner was (a) interest upon an "obligation" of the United States, and (b) that the United States was to be regarded as a resident of the United States within the meaning of the statute (R. 38). By necessary implication, the Circuit Court of Appeals held (c) that the interest was not exempt from taxation under the provisions of Section 213 (b) (4) and (d) that the interest was not such as to entitle the petitioner to a credit in the amount thereof, pursuant to Section 236.

Specification of Errors to Be Urged.

The Circuit Court of Appeals for the Second Circuit erred:

(1) In holding that the interest paid to the petitioner upon the refund of taxes previously overpaid fell within the category of "interest on bonds, notes, or other interest-bearing obligations" within the meaning of Sections 217 and 233 of the Revenue Act of 1926.

(2) In holding that the United States was a resident of the United States within the meaning of Section 217 of the Revenue Act of 1926.

(3) In holding that such interest was not exempt from taxation under the provisions of Section 213 (b) (4) (C) of the Revenue Act of 1926.

(4) In holding that the petitioner was not entitled to a credit against its income in the amount of such interest, pursuant to Section 236 of the Revenue Act of 1926.

(5) In reversing the judgment of the Board of Tax Appeals.

Summary of Argument.

I. Foreign corporations are taxable only upon such interest as clearly falls within the precise definitions of Section 217, all other interest received by such corporations being expressly excluded from the field of taxability. The only class of taxable income into which the interest on the refunds here involved might fall is "interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise" of the United States. The word "obligations" as used in Section 217 has the meaning of duties originating in contracts and does not include statutory duties such as the duty to refund taxes illegally collected. This definition is dictated (a) by the rule of strict construction, which is applicable because this is a provision imposing a tax, (b) by the rule of *ejusdem generis,* which requires that the word "obligations" be likened to "bonds" and "notes", and (c) by the logical requirement of consistency, since the word "obligations" has been held to have the narrower meaning in every other provision of the same statute which has been the subject of judicial decision. The last ground assumes that the

decisions referred to, which are decisions by Circuit Courts of Appeal in which this Court has denied certiorari (*American Viscose Corporation* v. *Commissioner,* 56 F. (2d) 1033, certiorari denied 287 U. S. 615; *United States Trust Co. of New York* v. *Anderson,* 65 Fed. (2d) 575, certiorari denied 290 U. S. 683), are correctly decided. If they are not correctly decided, it will be clear that the petitioner is entitled to a reversal of the judgment under other provisions of the statute.

II. Even if these refunds are "obligations of the United States", the income does not fall within the taxable class because the United States is not a "resident" of the United States. The petitioner relies (a) upon the ordinary significance of the word "resident", and (b) upon the propositions that it is apparent from the Revenue Act of 1926 as a whole that wherever Congress intended a reference to the United States, explicit words expressing that intention were used; and that the word "resident" is never used in the statute in such a sense as to include the United States.

III. If the word "obligations" as used in Section 217 is given the broad meaning which would make this income taxable, the same meaning must be given to the same word in Section 213 (b) (4) (C), and the interest is hence expressly exempt from taxation, *i. e., American Viscose Corporation* v. *Commissioner* (*supra*), and *United States Trust Co. of New York* v. *Anderson* (*supra*) were wrongly decided. The same rule of construction is applicable to the two sections and the context affords no basis for a differentiation of meaning.

IV. It is the intention of the Revenue Act of 1926 unequivocally expressed in Section 213, relating to "exemp-

tions'' and Section 236, relating to ''credits'', to exclude from the income of foreign corporations upon which the corporation income tax is imposed, all interest which may fall within any possible definition of ''interest upon obligations of the United States''. The plain terms of the statute and the history of the Federal tax legislation from 1918 to 1926 show clearly that such interest was never intended to be subjected to any taxation, except the war-profits and excess-profits tax which was enacted in 1918 and ceased to be in effect after 1921, and the tax imposed by Section 220.

I.

The word ''obligations'' as used in Section 217 (a) (1), relating to foreign corporations and non-resident aliens should be construed in the sense of contractual duties and not in so broad a sense as to embrace statutory duties such as the duty to refund taxes illegally collected.

This proposition rests upon three grounds.

1. **Section 217 (a) (1) is a provision defining specific subjects of taxation and must hence be strictly construed in favor of the taxpayer.**

Taxation of foreign taxpayers, *i. e.*, foreign corporations and non-resident aliens, follows a scheme essentially different from that applicable to domestic taxpayers, *i. e.*, domestic corporations, citizens and residents. In the case of domestic taxpayers, the statute includes in gross income every conceivable form of income which Congress has the power to tax. Section 213, which is controlling with respect to domestic taxpayers, provides in sub-section (a):

> "The term 'gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or
>
> from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property;
>
> also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or
>
> gains or profits and income derived from any source whatever."

Certain exemptions are provided for in sub-section (b) of Section 213; but these are exceptions to the general rule of taxability. The exceptions are expressed in specific language.

The basis for taxation of foreign taxpayers is in sharp contrast with these provisions applicable to domestic taxpayers. With respect to interest, the contrast is particularly marked. It may fairly be said that so far as interest received by foreign taxpayers is concerned, taxability is the exception instead of the rule. All interest which is not included within precise definitions is comprehensively excluded. The statute provides (Sec. 233 (b)) "In the case of a foreign corporation, gross income means *only* gross income from sources within the United States, determined * * * in the manner provided in Section 217", and Section 217 specifically sets forth the items of income which *shall be* treated as income from sources within the United States, specifying in the case of interest only "interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise". (Sec. 217 (a) (1).) Section 217 (c) then provides: "The following items of gross income *shall be* treated as income from sources without the United States: (1) Interest

other than that derived from sources within the United States as provided in paragraph (1) of sub-division (a);" (Italics ours.)

It is clear from the foregoing that Sections 217 and 233 are provisions imposing a tax and defining the subjects of taxation, not provisions for exemption. They are hence to be construed strictly against the government and in favor of the taxpayer.

United States v. *Merriam*, 263 U. S. 179;
Reinecke v. *Northern Trust Company*, 278 U. S. 339;
Burnet v. *Niagara Falls Brewing Co.*, 282 U. S. 648;
Gould v. *Gould*, 245 U. S. 151.

It follows that the words "interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise" should be held to include interest on refunds of taxes illegally collected only if there be no fair doubt as to whether such interest falls within the specific terms of the statute.

It cannot be said that the word "obligation" includes, without a fair doubt, the statutory duty of the United States to pay interest on illegally collected taxes. As used in the particular statute now under consideration, two recent cases recognize that the word is variable in meaning and the necessity, in order to fix its meaning, for determining the appropriate canon of construction.

United States Trust Co. of New York v. *Anderson*, 65 F. (2d) 575, certiorari denied 290 U. S. 683;
American Viscose Corporation v. *Commissioner*, 56 F. (2d) 1033; certiorari denied 287 U. S. 615.

In *United States Trust Co. of New York* v. *Anderson* (*supra*), the rule of strict construction was found applicable

and under the influence of that rule the word "obligations" was held not to include in its meaning the duty of a city to pay an award in condemnation proceedings. In *American Viscose Corporation* v. *Commissioner* (*supra*), it was held similarly not to include the statutory duty of the United States to refund taxes illegally collected.

In *United States Trust Co. of New York* v. *Anderson* (*supra*), the Court at page 577 said:

> "In determining the scope of the word we must bear in mind the settled rule of construction that 'tax exemptions are never lightly to be inferred' * * * and will not be applied to a particular case unless granted in the statute in plain terms * * *."

In *American Viscose Corporation* v. *Commissioner* (*supra*), the Court at page 1033 said:

> "The Tax Board, following the principle stated in *Kansas City Southern Railway Co., et al.* v. *Commissioner*, 16 B. T. A. 665, held this refund was not exempt by the act. We agree with that conclusion."

The *Kansas City Southern Railway* case involved the application of the rule of strict construction and it is to be inferred that that was the "principle" to which the Court referred.

It is true that the reason for applying the rule of strict construction in the cited cases is not the same as in the instant case. In the cited cases, arising under Section 213 (b), strict construction was adopted because an exemption from taxation was involved; in the instant case, arising under Sections 233 and 217, strict construction is to be adopted because of the rule relating to statutes imposing taxation. But, whatever the reason for it, the rule is the same in both cases.

It may also be true that it does not necessarily follow from the application of the same rule of construction that exactly the same meaning must be given to the word "obligation" in the two different provisions of the statute. There may be more than two shades of meaning in the same word, and the context or the probable purpose of the enactment may indicate that the line between what is included and what is excluded is to be placed differently in the two cases, notwithstanding the application of the same rule of construction. It will be found, however, that in the two cases now the subject of comparison, the line of demarcation for the definition is to be given the same location, *i. e.*, between duties arising from contract and those imposed by force of law. It will be convenient to defer the discussion of this question until the provisions of Section 217 (a) have been analyzed and the precise limitations of the meaning of the word "obligation", as used therein, determined with the aid of the rule of *ejusdem generis.*

2. **The rule of ejusdem generis is applicable to the construction of Section 217 (a) (1).**

Section 217 (a) (1) imposes the tax on interest on "*bonds, notes,* and other interest-bearing obligations". The word "obligations" must therefore be assimilated to something in the nature of bonds and notes.

> *Goldsmith* v. *United States,* 42 F. (2d) 133, certiorari denied, 51 S. Ct. 26.

Other provisions of Section 217 make a more precise definition possible. Section 217 (a) (1) (A) excludes from the class of taxable interest "interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States and not having an office or place of business therein". The petitioner and

the respondent agree that this exception would not have been thought necessary if bank deposits had not been considered within the category of "obligations". But if bank deposits are regarded as obligations, it is manifest that the word is broader in scope than instruments given for borrowed money. It follows that in order to give full effect, on the one hand, to the limitation of meaning indicated by the words "bonds" and "notes", and, on the other hand, to the extension of meaning required in order to include bank deposits, obligations must be defined as including all duties contractual in origin, but excluding statutory duties.

We return now to the exemption provisions of Section 213 (b) for the purpose, if possible, of defining with the same degree of precision the word "obligation" as used therein. If the *United States Trust Co. of New York* case (*supra*) and the *American Viscose Corporation* case (*supra*) are accepted as authorities, statutory duties are excluded from the exempted class of "obligations" under this section. In those cases the question whether debts not arising from borrowing were within the definition, was not involved, but there are dicta in the opinions which suggest that the exemption should be so limited. It will be seen, however, that such a narrow limitation would be inconsistent with a controlling expression of the legislative will. We call the Court's attention to Article 77, Regulation 62 of the Treasury Department, adopted in 1922, which was apparently overlooked by counsel in the presentation both of the *United States Trust Co. of New York* case (*supra*) and the *American Viscose Corporation* case (*supra*). This regulation reads as follows:

> "Art. 77. INTEREST UPON UNITED STATES OBLIGATIONS. * * * Interest credited to postal savings accounts upon moneys deposited in postal savings banks is exempt from income tax * * *. (Art. 77, Reg. 62.)"

Since this regulation was in force when the provisions of Section 213 were enacted in 1924 and re-enacted in 1926, it has, in accordance with established principles of law, the same force as if embodied in the statute. (*Skinner* v. *Eaton*, 45 F. (2d) 568.) It follows that under Section 213 (b) as well as under Section 217 (a) (1), all of the authorities and other available tests of meaning can be harmonized only by a definition which includes all duties having their origin in contract, but excludes all which are not in that respect analogous to bonds and notes.

3. **The petitioner's construction is required for consistency.**

The petitioner's construction makes Section 217 (a) (1) consistent not only with Section 213 (b), but also with Section 236, as that section has been construed by the Courts. That section allows to all corporations, foreign and domestic, a "credit" of the amount of all interest on "obligations of the United States" in so far as such interest is required to be included in gross income under Section 233. It was therefore necessary in *American Viscose Corporation* v. *Commissioner* (*supra*), in order to reach the conclusion that the taxpayer, a domestic corporation, was taxable upon interest on a refund of Federal taxes, to find not only that the interest was not "exempt" under Section 213 (b), but also that it was not income against which the taxpayer was entitled to a "credit" under Section 236.

We shall argue under a later point that both of those propositions cannot be true. But reserving our argument on that point, it is clear that the decision of the Circuit Court of Appeals, in the *American Viscose Corporation* case (*supra*), holding the income taxable, necessarily involved a determination that "obligations" as used in Sec-

tion 236 is not used in the broad sense which includes statutory duties. If, the word as used in Section 236 is construed in the narrower sense, the logic of the decision as applied to the construction of Section 217 (a) (1), will require the conclusion that the interest in question is not within the taxable class; for it will lead to the demonstration that (1) the word "obligations" is used uniformly throughout the statute in its narrower sense, and (2) that that construction is adopted even where there is no context restricting the meaning.

(1) The only other uses of the word "obligations" in the income tax law are found in Sections 214, 216, 220, 221, 234, 245 and 257. It is unnecessary to review particularly all of these provisions; it will suffice to point out that they are all analogous to those contained in Sections 213 or 236 and obviously require the same construction. It will not easily be inferred that in Section 217 (a) (1) alone the word was used in a different sense.

(2) If in either section of the statute "obligations" should be given a broad meaning it is not in Section 217 but in Section 236, since in Section 236 there are no specific words to which the word "obligations" is to be assimilated, such as "bonds" and "notes" in Section 217 (a) (1).

It is submitted that the cumulative effect of the rule of strict construction, of the rule of *ejusdem generis,* and of the legislative definition of the word "obligations" as manifested by its accepted signification elsewhere in the same statute (assuming that *American Viscose Corporation* v. *Commissioner* (*supra*) and *United States Trust Co. of New York* v. *Anderson* (*supra*), were correctly de-

cided) will, unless overcome by evidences of a legislative intention to the contrary, require the acceptance of the petitioner's construction.

The reasons given by the Court below in support of its conclusion that Congress intended to tax foreign corporations on interest on tax refunds, are untenable.

1. The statement is reiterated in the opinion below that the income involved is in *fact* income derived from sources within the United States and that therefore it should be "treated as" such income under the provisions of Section 217 (a) (1); but this is a *non sequitur*. The evident purpose of the Revenue Acts of 1924 and 1926 was to substitute for the test of the *fact*—a test which in practice under the earlier Acts had proved "obscure and economically unsound" (see Finance Committee of Senate Report No. 275, 67th Congress, 1st Sess., p. 16)—an allocation based upon specific classifications. The very use of the expression that certain classes of interest were to be "treated as" derived from sources within the United States, and all other classes of interest to be "treated as" derived from sources without the United States, indicates that the specific provisions were to be absolutely controlling. For example, by the plain terms of Section 217 (a) (1), interest on deposits paid by American bankers to non-resident aliens not engaged in business and having no offices within the United States is to be "treated as" income derived from sources without the United States; yet in *fact* such interest is derived from sources within the United States in precisely the same sense as interest on a refund of Federal taxes. The words "income derived from sources within the United States" and "income derived from sources without the United States" are no more than a convenient

label or collective designation by which to avoid awkward repetition of the numerous specific classes of income which are to be taxed or not to be taxed. They throw no more light on the legislative intention than if the legislature had used in their place some such colorless expression as "income of the first class" and "income of the second class".

2. It is said in the opinion below that "no sufficient reason is advanced for exempting a foreign corporation when a domestic corporation is taxed" (R. 36). It is a complete answer to this that Congress has adopted wholly different tests for determining the taxability of income in the two cases. Residents and domestic corporations are taxed upon all gross income as defined in Section 213, subject to certain exemptions and credits. In the case of non-residents and foreign corporations, by the provisions of Sections 217 and 233, income taxes are imposed only upon specific and definite items or kinds of income as defined therein (subject to the same exemptions and credits allowed under Sections 213 and 236), and all classes of income other than those specifically included in Section 217 are excluded from the field of taxability. For example, interest on deposits paid by American bankers to foreign corporations not engaged in business and having no places of business in this country, is not taxed (Section 217 (a) (1) (A)), although our own citizens and domestic corporations are taxed with respect to such interest. Congress having unequivocally made the differentiation, the Courts are not concerned with the reasons for it. Such reasons, however, are in fact not difficult to suggest. Taxation of foreigners is largely a matter of reciprocity. In showing consideration for foreigners, Congress may wisely have had "remembrance of ourselves" in connection with foreign taxation

of our own citizens. As this Court said in *Barclay & Co.* v. *Edwards,* 267 U. S. 442, 451:

> "Considerations of policy toward foreign countries may very well justify an exemption of the foreign corporations from taxes that might legitimately be imposed on them, but which Congress does not think it wise to exact."

It may have been regarded as reasonable, moreover, to tax foreigners only on interest on capital which was here for the purposes of investment or commerce, and hence in competition with American capital and unreasonable to tax them on interest which is in essence part of compensation awarded them for wrongs which they have suffered at the hands of our government or citizens.

The discussion in the opinion below of the decisions in *United States Trust Co. of New York* v. *Anderson* (*supra*) and *American Viscose Corporation* v. *Commissioner* (*supra*) carries the Court's fallacious assimilation of foreign to domestic taxpayers to a conclusion which convincingly demonstrates the fallacy. Judge MANTON says (R. 35):

> "In *U. S. Trust Co.* v. *Anderson, supra,* we held that interest on condemnation awards was taxable as an obligation of a subdivision of a State. There is no substantial difference, in the viewpoint of taxation, between the obligation of a city to pay interest on an award and the obligation of the United States to pay interest on an overpayment of taxes, none of which were exempt later fom taxation. In *American Viscose Co.* v. *Comm'r, supra,* the tax was imposed upon a domestic corporation for interest on refunded taxes."

There is no sign of recognition in this of the fact that the taxpayers in the *United States Trust Co. of New York* case (*supra*) and the *American Viscose Corporation* case

(*supra*) were domestic taxpayers, unquestionably taxable upon the income involved unless it was interest on an "obligation" and hence exempted; whereas, in the instant case, the taxpayer is a foreign corporation, unquestionably *not* taxable upon the income involved, unless it was interest on an "obligation".

3. In support of its conclusion that the word "obligation" does not mean the same thing in Section 217 (a) (1) as it does in Section 213 (b), the opinion below refers to the "legislative history" of the two sections and finds that "it is a fair inference that Section 217 is the broader of the two" (R. 34). The opinion proceeds as follows, with respect to Section 217:

> "In its first form (as section 10 of the Revenue Act of 1916, 39 Stat. 765), it was apparently intended to extend the taxing power to situations not thought by the Attorney General (30 Ops. Attys. Gen. 435) to be included in the law as it then stood. Its present form, as indicated by the report of the Finance Committee of the Senate (Report No. 275, 67th Congress, 1st Sess., p. 16) is no retreat from that position, but rather a qualification and more explicit statement of that extension. We thus have revealed a purpose to enlarge the scope of the statute."

It will be clear, not only from the report of the Finance Committee of the Senate dealing with the 1921 Act referred to in the opinion below, but from a mere comparison of the 1921 Act (from which the 1926 Act derives) with the earlier Acts, that the revision embodied in the 1921 Act did not "reveal a purpose to enlarge the scope of the statute", but was intended to change the whole scheme and theory of taxation of foreigners in the interest of clearness and precision. From one sub-sec-

tion of eight lines contained in the 1918 Act, the provisions taxing such taxpayers, were changed to and succeeded by a section of the 1921 Act consisting of fifteen subdivisions and ninety-three lines. From a few general terms the provisions were changed to detailed and specific definitions. From the general rule that the sources of the income was the criterion for its taxability, the criterion became the precise definitions contained in the Act. And, most significant, from the general rule that all interest which could be reached by the United States was taxable, the 1921 Act provided that no interest was taxable, except such as came within the defined exceptions to the rule. We quote the report of the Finance Committee of the Senate on the subject:

> "Section 217 states explicit rules—applicable principally to non-resident aliens and foreign traders—for computing the net income derived from sources within the United States. The present law is both obscure and economically unsound, inasmuch as the Attorney General has held that where goods are manufactured or produced in the United States and sold abroad, no part of the profit is derived from a source within the United States. This section explicitly allocates certain important sources of income to the United States or to foreign countries, as the case may be, and with respect to the remaining income (particularly that derived partly from sources within and partly from sources without the United States) authorizes the Commissioner, with the approval of the Secretary, to determine the income derived from sources within the United States, either by rules of separate allocation or by processes or formulas of general apportionment."

In view of the foregoing, the Court below was clearly unwarranted in deciding the case, a foreign corporation

being the taxpayer, upon the theory that "It has long been Congress' desire to extend income taxes to all forms of taxable income." (Opinion below, R. 36.)

II.

The United States is not a "resident" of the United States, "corporate or otherwise", within the meaning of Section 217 of the Revenue Act of 1926.

It is well settled that in construing a tax statute

> " 'The legislature must be presumed to use words in their known and ordinary signification' * * * 'The popular or received import of words furnishes the general rule for the interpretation of public laws' * * * 'the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover.' This rule is applied to taxing acts. *DeGanay* v. *Lederer,* 250 U. S. 376, 381."
>
> *Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552, 560.

Again,

> "The words of the statute are to be taken in the sense in which they will be understood by that public in which they are to take effect. Science and skill are not required in their interpretation * * *."
>
> *United States* v. *Isham,* 84 U. S. (17 Wall.) 496, 504.

> "Our duty is to read the statute according to the natural and obvious import of the language, without resorting to subtle and forced construction * * *."
>
> *U. S.* v. *Temple,* 105 U. S. 97, 99.

The authorities cited under our first point demonstrate that the rule of strict construction is applicable to the word "resident" as well as to the word "obligations". If a doubt exists, it must be resolved against the government and in favor of the taxpayer. We refer to our first point also for the proposition that there is nothing in the statute to indicate any general intention to tax foreign corporations except upon income clearly falling within the specifications of Section 217.

In *Helvering* v. *Stockholms Enskilda Bank*, 68 F. (2d) 407, and *State, A. R. Montgomery, Prosecutor* v. *Inhabitants of the City of Trenton*, 40 N. J. L. 89, the question whether the State is a "resident" has been decided favorably to petitioner's contention. The *Stockholms Enskilda Bank* case (*supra*) arises from the same state of facts as that presented in the case at bar and is now under review by this Court. In *State, A. R. Montgomery, Prosecutor* v. *Inhabitants of the City of Trenton* (*supra*), it was held by the Supreme Court of Judicature of the State of New Jersey that indebtedness to the State could not be deducted from the taxable value of property under a statute permitting the deduction of indebtedness to "residents". The Court said:

> "It is only by the greatest latitude of construction that we can say that the state resides within the state. The word 'residing' refers to individual abode, although it is sometimes used figuratively. It will not apply to the state in its representative and governmental relation to its citizens. The people, as individuals, reside in the state, but the political body called the state cannot be said, in the proper use of language, to reside anywhere."

The opinion below dismisses this authority with the following comment:

> "The *State* v. *City of Trenton, supra,* turned on the intent of the Legislature, declared by the court to be manifest, that the debtor should not be released from taxation unless the tax could be collected from the creditor." (See Opinion below, R. 35.)

But if the word "residents" included the State within its meaning without doubt or ambiguity, the Court could not have held that the State was not a "resident" by reasoning to the effect that the legislature intended something other than what it said. It follows that the case is at the least authority for the proposition that the word "resident" is a word of doubtful or ambiguous meaning. A fair doubt requires a decision in favor of the taxpayer.

Other authorities are persuasive, if of indirect bearing, upon the question of legislative intent. In determining the class of persons upon whom a tax is imposed, the Courts have uniformly held that the government which imposes the tax is not to be understood as included unless express words to that effect are used. In *Van Brocklin* v. *State of Tennessee,* 117 U. S. 151, 173 this Court said:

> "General tax acts of a State are never without the clearest words, held to include its own property * * *."

In *California Iron Yards Co.* v. *Commissioner,* 47 F. (2d) 514, 516, it was said:

> "It is a fundamental rule of construction that general language in a statute does not apply to the sovereign."

It is a fair presumption of fact that the draftsmen of the Federal income tax laws were familiar with the principles applied to the construction of tax laws generally. It would naturally occur to the mind of the expert draftsman that if the clearest words were necessary in order to identify the government for one purpose, identification for any

other purpose should not be left to vague implication. That this is a correct supposition with respect to the Revenue Act of 1926, is evidenced by the fact that the Act contains repeated references to the United States, the States and their subdivisions in direct and explicit language, and that no other instance has been cited in which such a reference is made by the use of other than direct and explicit language.

Not only is the United States identified by precise language wherever else in the statute it might possibly be meant, but a painstaking examination of the statute and the regulations has not disclosed any instance in which the word "resident", frequently used in both, has been used in a sense which might include a political body.

In these circumstances the language and reasoning of the Court in *Davis* v. *Pringle,* 268 U. S. 315, become pertinent. In that case the question was whether the Bankruptcy Act should be so construed as to give a general preference to debts due the United States under the expression "(5) debts owing to any *person* who by the laws of the States or the United States is entitled to priority". In holding that an examination of the Act as a whole made it clear that it was not intended to include the United States within the meaning of the word "person" in this provision, Mr. Justice Holmes said at page 318:

> "It is incredible that after the conspicuous mention of the United States in the first place at the beginning of the section and the grant of a limited priority, Congress should have intended to smuggle in a general preference by muffled words at the end. The States are mentioned in (5) before the United States showing that their laws were primarily in mind. The United States seems added to avoid some possibly overlooked case. The ordinary dignities of speech would have led to the mention of the United States

> at the beginning of the clause, if within its purview. Elsewhere in cases of possible doubt when the Act means the United States it says the United States."

Some of the reasoning of the Court below in support of its conclusion that the United States is to be regarded as a "resident" leads to manifest inconsistencies. It is said in the opinion below (R. 35):

> "The United States is a corporation. *Respublica* v. *Sweers*, 1 Dall. 41, 44, 1 L. Ed. 29; *United States* v. *Maurice*, 2 Brock. (U. S.) 96, 109 Fed. Cas. No. 15747 (per MARSHALL, *J.*). As such corporate entity, it must have a corporate residence; that residence must be within the United States".

But one cannot read the Revenue Act of 1926 without its becoming clear that wherever reference is made to corporations it is creatures of the State and not the State itself which are intended. The definition of corporations in Section 2 (2), which expressly includes "associations, joint stock companies, and insurance companies", implies that political entities are excluded. See also Section 214 (a) (10) where it is apparent that contributions to the United States are distinguished from contributions to "domestic corporations"; and Section 256 (2), which uses the language

> "* * * interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations".

The reference to foreign countries would have been wholly unnecessary if nations had been regarded as corporations.

We are not unmindful in this connection of the recent decision of this Court in *Ohio* v. *Helvering*, 292 U. S. 360. That case held that a state which exercised a monopoly

of the sale of liquor might be included within the meaning of the word "person" as used in the internal revenue laws imposing a tax on "persons" dealing in liquor, but it obviously does not go so far as to hold that the Federal government, the entity imposing the tax, would be held to be included within the taxable class under this language.

III.

If the word "obligations" as used in Section 217 is given the broad meaning which would make interest on tax refunds taxable, the same meaning must be given to the same word in Section 213 (b) (4) and the interest is expressly exempted from taxation.

It is said in the opinion below that "the meaning given to the word used in one connection is not necessarily the meaning to be attributed to it when employed in other connections" (R. 34), but in the case of a highly technical statute, the result of repeated revisions by experts, there is at least a strong presumption of uniformity of meaning of the same word throughout (*Atlantic Cleaners & Dyers* v. *United States*, 286 U. S. 427, 433, citing *Courtauld* v. *Legh*, L. R. 4 Exch. 126, 130). We refer to our argument under Point I (*supra*), pages 10-21, for the propositions that there is nothing in the context or the legislative history of the two provisions which justifies any differentiation of meaning; and that the same rule of construction is applicable to both provisions.

While it is of no practical consequence to the present taxpayer what meaning is given to the word "obligations" in these two provisions, provided only that the meaning is uniform, we deem it our duty to reiterate one

consideration which clearly tends toward a more liberal construction of the exemption provisions of Section 213 (b) (4) than was adopted in the *American Viscose Corporation* case (*supra*) and the *United States Trust Co. of New York* case (*supra*). The limitation of the exemption by these decisions to instruments such as bonds, is plainly inconsistent with Article 77, Regulation 62 of the Treasury Department (which has received the endorsement of Congress and has hence the same weight in determining the legislative intention as an express enactment), which regulation so construes Section 213 (b) (4) (C) as to make interest on deposits in postal savings banks exempt as "interest upon obligations of the United States".

IV.

It is the intention of the Revenue Act of 1926, unequivocally expressed in Sections 213 and 236, to exclude from the income of foreign corporations upon which the corporation income tax is imposed by Section 230 of the Act, all interest which may fall within any possible definition of "interest upon obligations of the United States". The history of the Federal income tax legislation from 1918 to 1926, shows clearly that such interest was never intended to be subjected to any taxation, except the war-profits and excess-profits tax which was enacted in 1918 and ceased to be effective after 1921, and to the tax imposed by Section 220.

Our argument on this point is based on the hypothesis that the word "obligations" and the word "residents" as used in Section 217 are to be given the meaning attributed

to them by the Court below and that the interest is not exempt under Section 213 (b) (4). It will be contended that even upon this hypothesis the conclusion that the income is not taxable is required by Section 236.

It is submitted that the following propositions are incontrovertible and self-evident from a reading of the statute:

1. Nothing can be included in "gross income" of a foreign corporation, except by virtue of the definitions contained in Section 217 and adopted by Section 233. These sections select out of "gross income", as defined generally in Section 213 (a), certain items as objects of taxation for foreign corporations and certain others for exclusion from taxation. With a single exception applying to mutual marine insurance companies, not pertinent to the present discussion, they *add* nothing to the definition of "gross income" contained in Section 213 (a).

2. By Section 213 (b), interest on certain, but not all "obligations of the United States" is exempted and hence excluded from "gross income" of any taxpayer, foreign or domestic. Our hypothesis is that this exemption does not include interest on tax refunds.

3. By the provisions of Section 236, all interest on "obligations of the United States", which is included in the "gross income" of any corporation, foreign or domestic, under Section 233, is the subject of a "credit". Section 236 provides clearly that the "credit" be determined and measured by the amount of the "inclusion". In the case of a domestic corporation, the amount of the "inclusion", and hence the amount of the "credit", is obviously the whole amount of interest on "obligations of the United States", which is not exempted under Section 213

(b) (4), since for domestic corporations the definition of "gross income" includes, without qualification or condition, all interest. In the case of foreign corporations, however, interest on "obligations of the United States" is included in "gross income" under Sections 233 and 217, and hence included in the "credit", only if it is "interest on bonds, notes or other interest-bearing obligations of residents"; since all other interest is expressly excluded from "gross income" of foreign corporations. If interest on a tax refund from the United States is interest on an "obligation" under this provision, it is *a fortiori* interest on an "obligation of the United States", *i. e.,* if it meets the test for inclusion in "gross income" under Sections 233 and 217, it meets the test for inclusion in the "credit" under Section 236. Any other conclusion necessitates the quite unreasonable assumption that despite the clear intention of Congress (1) to measure the credit for interest on "obligations of the United States" by the amount of inclusion of interest on such "obligations" under Sections 233 and 217, and (2) to make the test for inclusion under Sections 233 and 217, whether the interest is interest on an "obligation", it nevertheless used the word "obligations" in these two closely linked provisions with two different meanings.

4. The sole purpose of including any interest on "obligations of the United States" in "gross income" of corporations was to subject it to the war-profits and excess-profits tax which was not in effect after 1921, and to the 50% tax, which is in the nature of a penalty, imposed by Section 220.

It follows that *American Viscose Corporation* v. *Commissioner* (*supra*), as well as the decision of the Circuit Court of Appeals in the case at bar, are erroneous.

One naturally seeks an explanation of why two Circuit Courts of Appeals should have rejected a conclusion which seems to be so precisely demonstrable. The probable explanation is the difficulty of believing that Congress intended so apparently futile a proceeding as to add a given item to gross income and forthwith subtract the same item. That difficulty will disappear when the practical machinery for reporting income under the 1918 and 1921 Acts is recalled. The corporation income tax and the corporation war-profits and excess-profits tax were both determined on the basis of a single return. For the purpose of the war-profits and excess-profits tax, the item of taxable interest on "obligations of the United States" was necessarily to be reported. It was evidently considered convenient first to show on the report the aggregate income on the basis of which the war-profits and excess-profits tax was determined, and then to reduce that figure by a "credit" in the amount of the items which were subject to the war-profits and excess-profits tax, but not subject to the income tax. When the war-profits and excess-profits tax was repealed, the principal reason for this roundabout method of calculation was taken away; but there is not the slightest basis for reasoning that the repeal of the war-profits and excess-profits tax was intended to make classes of income subject to the corporation income tax which were not so subject to it before the repeal of the war-profits and excess-profits tax.

The discussion of the subject in the opinion below (R. 37) is in agreement with these contentions, except that the Court apparently regarded the following language in Section 236:

> "The amount received as interest upon obligations of the United States which is included in gross income under section 233 * * *."

as embracing only interest upon such government bonds issued after 1917 as are specifically excepted from the exemption granted by sub-section (b) (4) of Section 213, and not embracing interest on tax refunds from the United States, even though such refunds are included in gross income under Sections 233 and 217, by reason of being regarded as "obligations". The opinion says (R. 37):

> "So far as corporations are concerned, sections 213, 233, and 217 of the 1924 and 1926 acts * * * includes in 'gross income' interest upon certain of the bonds of the United States issued in the borrowing of money, and section 236 takes it out. Congress, we think, used the word 'obligations' in section 236 in reference to those obligations the interest upon which it specifically included in gross income."

The reference to Section 213 in this statement is confusing and unnecessary. By the terms of Section 236, the "credit" is measured by the inclusion of the interest under Section 233. In the case of foreign corporations, it is Section 233 (b) (as amplified by Section 217), and not Section 213, which determines whether or not such inclusion exists. Consequently the word "obligations" as used in Section 236 and applied to foreign corporations should logically be given the sense in which it is used in Section 217; the sense in which it may be used in Section 213 is irrelevant.

With respect to domestic corporations, the question is not precisely the same. The inclusion of interest on "obligations of the United States" in gross income of domestic corporations depends upon the definitions of Section 213 (a), which does not use the word "obligations", but includes all interest. It is to be noted that the Court below has made a somewhat inaccurate use of language in

its reference to "obligations the interest upon which it [*i. e.*, Congress] specifically included in gross income", under Section 213. Such interest on "obligations of the United States", as is included in gross income of domestic taxpayers is so included not by virtue of Section 213 (b), which specifically *exempts* certain "obligations", but by virtue of the affirmative provisions of Section 213 (a).

Conclusion.

For the foregoing reasons we respectfully submit that the judgment below should be reversed.

Respectfully submitted,

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